

Under the Service Occupation Tax Act, servicemen are taxed on tangible personal property transferred incident to sales of service. See 86 Ill. Adm. Code 140.101. (This is a GIL).

March 16, 2000

Dear Xxxx:

This letter is in response to your letter dated January 10, 2000. The nature of your letter and the information you have provided require that we respond with a General Information Letter, which is designed to provide general information, is not a statement of Department policy and is not binding on the Department. See 2 Ill. Adm. Code 1200.120(b) and (c), enclosed.

In your letter, you have stated and made inquiry as follows:

On behalf of one of our clients we respectfully request your opinion regarding the proper sales and use tax treatment of the transactions described below. For your convenience, responses may be made on this letter and returned in the enclosed envelope. We would appreciate your response by February 15, 2000 or at least an acknowledgement of receipt of the inquiry and an indication of when a response may be anticipated.

Our client is a manufacturer and retailer of computer hardware, software and *business products* with sales primarily to automobile dealers, *manufacturers, retailers and consumers*. In addition to the sale of hardware and software, various other services are also offered by the client to its customers including the following transactions:

Scenario #1

Client has the capability to develop an entire strategic marketing campaign. As an example, client will suggest that a clothing store with a new big man's section run a promotion.

Strategy

To emphasize the new fall clothing line of client's customer, a number of potential clothing store customers will be solicited to purchase from this line. Each will receive a letter with the details of the promotion, a card carrier designed to look like a cover of PUBLICATION, and inside a credit card with a value embedded for an undisclosed amount over a certain minimum.

Implementation

Client will compose the text design for the stationary and the credit card. Client will produce or acquire and assemble the pieces, *perform lettershop services (inserting, sealing, sorting and stamping)* and mail to the identified customers. Normally each process will be identified on the invoice to the clothing store.

- Would the services to develop the strategy for the marketing campaign be taxable?
Yes _____. No _____.

Please explain _____

- Which, if any, of the processes described above would be taxable if each is separately stated?

_____.

- If the entire process above occurred in another state and only the pieces were delivered to customers in your state, would anything be taxable?
Yes _____. No _____.

If yes, which items _____.

Scenario #2

Client, not an advertising agency, solicits their customers with creative concepts relative to the marketing of the third party's products. Client is involved in the creative aspects of advertising design of the marketing campaign. Client will develop the form layout for the marketing pieces. Client will import customer provided data. Finally, client will deliver the marketing pieces, customer invoices or other mail pieces. Such deliver normally involves *lettershop services (inserting, sorting, and stamping)* and mailing from a customer provided list.

- Assuming this sale took place in your state, would it be considered a service transaction, a sale of tangible personal property or a mixed transaction?
Service _____. Sale of tangible personal property _____. Mixed transaction _____.

- If this were a service transaction, would any segments be taxable, if each element were separately stated?
Yes _____. No _____.

If yes, which items? _____.

- If sale and service took place outside your state, but mail pieces were received in your state, would any segments be subject to USE tax?

Yes _____. No _____.

If yes, which items? _____.

- Does your state differentiate between creative design of content and form layout?

Yes _____. No _____.

If yes, how? _____.

Scenario #3

Client, again not an advertising agency, using third party data completes layout, formatting, and all further processes to produce direct mail advertising for their customer. Client then performs letter shop processes (folding, inserting, sorting, affixing postage) for delivery by the U.S. Post Office (USPS) to third party's customers or clients both within and without your state.

- If the sale took place in your state, would this be considered a service transaction?

Yes _____. No _____.

Would those items delivered outside your state be exempt as sales in interstate commerce?

Yes _____. No _____.

- If the sale and processes occurred in another state, and some direct mail advertising pieces were delivered in your state, would any tax be due?

Yes _____. No _____.

If yes, based on what amount? _____.

- If the sale and processes occurred in your state, and some direct mail advertising pieces were delivered in your state, some were stored in your state, and the majority delivered outside your state would any tax be due?

Yes _____. No _____.

If yes, based on what amount? _____.

Scenario #4

Client directs a trade partner to produce a financial newsletter. This newsletter is produced to the specifications of client's customer. As the instruction of client's

customer, client accepts delivery of the newsletters for mailing: some of these are mailed to locations in your state, some are mailed to locations outside your state, and some are stored in your state for 60 days and then destroyed. The cost of the financial newsletter is separately stated from the letter shop services (inserting, sealing, sorting and stamping). This newsletter is delivered free of charge to the recipients.

- If the sale occurs in your state, would the newsletters retained and/or delivered by mail in your state be taxable?
Yes _____. No _____.

If yes, which? _____.
- Would the newsletters delivered by USPS in your state be taxable?
Yes _____. No _____.
- Would the letter shop services be taxable?
Yes _____. No _____.
- If the only contact with your state were the receipt of the mailed pieces, would they be subject to use tax, sales tax or neither?
Use Tax _____. Sales Tax _____. Neither _____.
- If the newsletters were purchased with tax paid to the vendor, would any tax be due?
Yes _____. No _____.

Scenario #5

Client contracts with advertising agencies. These agencies contract with their customers to conceive, design, and format the direct mail advertising pieces for projects of the advertising agency *customers*. Client may be responsible for producing or acquiring, as well as assembling the advertising pieces, in addition to the letter shop services (inserting, sealing, sorting and stamping) to complete the project for the agency.

- If the above scenario is one bundled transaction, is it a sale of service or a mixed transaction?
Sale of service _____. Mixed transaction _____.

If it is a mixed transaction, does your state charge sales tax only on sales of tangible personal property?
Yes _____. No _____.
- If the charges in the above scenario are separately stated and itemized, would any be subject to tax? If so, which specifically?

Yes_____. No _____.

If yes, which items? _____.

- If the direct mail pieces are sold in your state and mailed into your state, would they be considered taxable?

Yes_____. No _____.

- If these pieces are sold in another state but mailed into your state would they be considered taxable if the agency has nexus in your state?

Yes_____. No _____.

- If these pieces are sold in another state but mailed into your state would they be considered taxable if the agency has no nexus with your state?

Yes_____. No _____.

- If the above scenario were between client and a merchant other than an advertising agency, would the answer differ? How?

Yes_____. No _____.

If yes, how? _____.

Scenario #6

Client conducts a statement *rendering* or invoice rendering service, including outsourcing of the billing function. Client receives data from their customer's accounts receivable department at some recurring interval. Client will purge, sort, aggregate, and arrange data in a billing format. This will be transferred to an invoice that client has on electronic image. These are imaged on to the individual invoices, and client performs letter shop services (inserting, sealing, sorting, and stamping) for their customer. These finished statements are delivered to the USPS and may or may remain in your state. Assume this scenario occurs in your state.

- Is this a service transaction or a sale of property?
Service transaction _____. Sale of property _____.

- Would this transaction be taxable if client billed the customer one lump sum?
Yes_____. No _____.

- If separately stated, would any of the elements of the transaction be subject to sales tax?

Yes_____. No _____.

If yes, which items? _____.

- If separately stated, would any of the elements of the transaction be subject to use tax?
Yes _____. No _____.

If yes, which items? _____.
- Assume the transaction in your state ends with the arrangement in a billing format. The data is then transferred electronically to another state. Would any tax be due in your state?
Yes _____. No _____.

If yes, with respect to which items? _____.
- If the scenario occurred in another state, would any part of a separately stated transaction be taxable in your state?
Yes _____. No _____.

If yes, which items would be taxable? _____.

Scenario #7

Client has developed a process for customers to electronically access information imaged on to a compact disc. Their customers only have capability to view the archived information, (a customer support function). Client retains the CD and no property is transferred to their customers.

- Assuming the entire transaction occurs in your state, would any part be taxable?
Yes _____. No _____.

If yes, which portion? _____.
- Would this be considered a data processing service?
Yes _____. No _____.
- Would client owe use tax on the purchase of the CD's?
Yes _____. No _____.
- If a client's customer views the information from a PC situated in your state, but the diskette resides on a server in another state, would any tax be due in your state?
Yes _____. No _____.

If yes, with respect to which items? _____.

- *If the data resides in a form other than a CD (ex. Data repository on a server, magnetic tape, etc.), would the answer to any of the above questions change?*

If yes, please elaborate _____.

We appreciate your timely response to this survey. If there is any way that we can facilitate an expeditious response, please feel free to contact me at #####.

We are unable to answer your letter in the format you request. Retailers' Occupation Tax and Use Tax do not apply to receipts from sales of personal services. Under the Service Occupation Tax Act, servicemen are taxed on tangible personal property transferred incident to sales of service. For your general information we are enclosing a copy of 86 Ill. Adm. Code 140.101 regarding sales of service and Service Occupation Tax.

The purchase of tangible personal property that is transferred to service customers may result in either Service Occupation Tax liability or Use Tax liability for the servicemen, depending upon which tax base the servicemen choose to calculate their liability. Servicemen may calculate their tax base in one of four ways: (1) separately stated selling price; (2) 50% of the entire bill; (3) Service Occupation Tax on cost price if they are registered de minimis servicemen; or, (4) Use Tax on cost price if the servicemen are de minimis and are not otherwise required to be registered under the Retailers' Occupation Tax Act.

Using the first method, servicemen may separately state the selling price of each item transferred as a result of sales of service. The tax is based on the separately stated selling price of the tangible personal property transferred. If servicemen do not wish to separately state the selling price of the tangible personal property transferred, those servicemen must use the second method where they will use 50% of the entire bill to their service customers as the tax base. Both of the above methods provide that in no event may the tax base be less than the cost price of the tangible personal property transferred. Under these methods, servicemen may provide their suppliers with Certificates of Resale when purchasing the tangible personal property to be transferred as a part of the sales of service. Upon selling their product, they are required to collect the corresponding Service Use Tax from their customers.

The third way servicemen may account for their tax liability only applies to de minimis servicemen who have either chosen to be registered or are required to be registered because they incur Retailers' Occupation Tax liability with respect to a portion of their business. Servicemen may qualify as de minimis if they determine that their annual aggregate cost price of tangible personal property transferred incident to sales of service is less than 35% of their annual gross receipts from service transactions (75% in the case of pharmacists and persons engaged in graphic arts production). See, 86 Ill. Adm. Code 140.101(f) enclosed. This class of registered de minimis servicemen is authorized to pay Service Occupation Tax (which includes local taxes) based upon the cost price of tangible personal property transferred incident to sales of service. Servicemen that incur Service Occupation Tax collect the Service Use Tax from their customers. They remit the tax to the Department by filing returns and do not pay tax to suppliers. They provide suppliers with Certificates

of Resale for the property transferred to service customers.

The final method of determining tax liability may be used by de minimis servicemen that are not otherwise required to be registered under Section 2a of the Retailers' Occupation Tax Act. Servicemen may qualify as de minimis if they determine that their annual aggregate cost price of tangible personal property transferred incident to sales of service is less than 35% of their annual gross receipts from service transactions (75% in the case of pharmacists and persons engaged in graphic arts production). Such de minimis servicemen may pay Use Tax to their suppliers or may self-assess and remit Use Tax to the Department when making purchases from unregistered out-of-State suppliers. Those servicemen are not authorized to collect "tax" from their service customers because they, not their customers, incur the tax liability. Those servicemen are also not liable for Service Occupation Tax. It should be noted that servicemen no longer have the option of determining whether they are de minimis using a transaction by transaction basis.

In multi-service situations, a primary serviceman's cost price is determined either by the separately stated selling price of the tangible personal property transferred from a secondary serviceman or if the secondary serviceman does not separately state the cost of goods, it is presumed that the primary serviceman's cost price is 50% of the secondary serviceman's total charge. See 86 Ill. Adm. Code 140.301, enclosed. When both primary servicemen and secondary servicemen are registered, primary servicemen may give a Certificate of Resale to registered secondary servicemen for any tangible personal property purchased. Primary servicemen could then collect Service Use Tax from their customers based upon the separately stated selling price of the property or 50% of the bill to the service customers. If primary servicemen are registered and de minimis, they may choose to remit Service Occupation Tax to the Department based upon their cost price of tangible personal property purchased from the secondary serviceman. If the cost price of the tangible personal property is not separately stated by the secondary serviceman, the cost price will be deemed to be 50% of the total bill from the secondary serviceman. Primary servicemen provide the secondary servicemen with Certificates of Resale if the secondary servicemen are registered.

Public Act 89-675, effective August 14, 1996, states that if an unregistered de minimis serviceman subcontracts service work to an unregistered de minimis secondary serviceman, the primary serviceman does not incur a Use Tax liability if the secondary serviceman (i) has paid or will pay Use Tax on his or her cost price of any tangible personal property transferred to the primary serviceman and (ii) certifies that fact in writing to the primary serviceman.

For general information purposes, we are enclosing a copy of 86 Ill. Adm. Code 130.605, which sets out the interstate commerce exemption from Illinois sales tax. The interstate commerce exemption is available to sales in which the Illinois seller is obligated to make delivery and does make delivery of tangible personal property to a location outside Illinois and the item is not to be returned to Illinois. See Section 130.605(b). However, please note that where the purchaser takes delivery in Illinois, the sale is taxable and this is true even though the purchaser will immediately remove the item from Illinois. See Section 130.605(a). In the service context, the interstate commerce exemption may only be utilized by servicemen remitting Service Occupation Tax to the Department (first three methods).

We have enclosed a copy of 86 Ill. Adm. Code 130.2105 describing the taxation of newspapers, magazines, books, sheet music, and phonograph records. Sellers of books, sheet music, and phonograph records incur Retailers' Occupation Tax liability when they sell those items to purchasers for use or consumption and not for resale. Sales of newspapers and magazines are not subject to tax. The transfer of tangible personal property as newsprint and ink for physical incorporation into newspapers or magazines is likewise not subject to Service Occupation Tax liability. See the enclosed copy of 86 Ill. Adm. Code 140.125(i).

Advertising supplements that will not be distributed separately, but which will be distributed only as inserts in newspapers, are generally considered to be a part of the newspaper. If the advertising supplements are a part of the newspaper they qualify for the newsprint and ink exemption under the Retailers' Occupation Tax Act and the Service Occupation Tax Act.

If advertising supplements are printed on special order and are distributed separately from newspapers (not as newspaper inserts), they will result in either Service Occupation Tax liability or Use Tax liability for the servicemen depending upon which tax base the servicemen choose to calculate their tax liability. See discussion above regarding the Service Occupation Tax.

Generally, sales of "canned" computer software are taxable retail sales in Illinois. See the enclosed copy of 86 Ill. Adm. Code 130.1935. However, if the computer software consists of custom computer programs, then the sales of such software may not be taxable retail sales. See Section 130.1935(c). Please note that computer software transferred electronically, for example over the Internet, are taxable retail sales in Illinois.

Custom computer programs or software are prepared to the special order of the customer. The selection of pre-written or canned programs assembled by vendors into software packages does not constitute custom software unless real and substantial changes are made to the programs or creation of program interfacing logic. See Section 130.1935(c)(3).

If transactions for the licensing of computer software meet all of the criteria provided in Section 130.1935(a)(1), neither the transfer of the software or the subsequent software updates will be subject to Retailers' Occupation Tax. A license of software is not a taxable retail sale if:

- A) It is evidenced by a written agreement signed by the licensor and the customer;
- B) It restricts the customer's duplication and use of the software;
- C) It prohibits the customer from licensing, sublicensing or transferring the software to a third party (except to a related party);
- D) The vendor will provide another copy at minimal or no charge if the customer loses or damages the software; and
- E) The customer must destroy or return all copies of the software to the vendor at the end of the license period.

As stated above, licenses of computer software are not taxable if they meet all of the criteria listed in Section 130.1935(a)(1). However, item (D) of that part requires the license to contain a provision requiring the vendor to provide another copy at minimal or no charge if the customer loses or damages the software. The Department has deemed software license agreements to have met this criteria if the agreements do not contain a provision about the loss or damage of the software, but the vendors' records reflect that they have a policy of providing copies of software at minimal or no cost if the customers lose or destroy the software.

Item (E) of this part also requires a license to require a customer to destroy or return all copies of the software to the vendor at the end of the license period. The Department has also deemed perpetual license agreements to qualify for these criteria even though no provision is included in the agreements that requires the return or the destruction of the software.

We note that you provide access to databases. Please note that the Telecommunications Excise Tax is imposed upon the act or privilege of originating or receiving intrastate or interstate telecommunications in Illinois at the rate of 7% of the gross charges for such telecommunications purchased at retail from retailers. See 86 Ill. Adm. Code 495, enclosed.

If Internet access service providers provide both transmission and data processing services, the charges for each must be disaggregated and separately identified. See 86 Ill. Adm. Code 495.100(c), enclosed. The statute does not require disaggregation on the customers' invoice, however. Therefore, it is the Department's position that so long as the non-telecommunications charges are disaggregated from the telecommunications charges in the retailers' books and records, for audit purposes, such disaggregation need not be shown on the customers' invoice. If the non-telecommunications charges are not disaggregated from the telecommunications charges, the full amount will be subject to Telecommunications Excise Tax. If none of the charges billed were for telecommunications, then none of the charges would be subject to tax.

I hope this information is helpful. The Department of Revenue maintains a Web site, which can be accessed at www.revenue.state.il.us. If you have further questions related to the Illinois sales tax laws, please contact the Department's Taxpayer Information Division at (217) 782-3336.

If you are not under audit and you wish to obtain a binding Private Letter Ruling regarding your factual situation, please submit all of the information set out in items 1 through 8 of the enclosed copy of Section 1200.110(b).

Very truly yours,

Melanie A. Jarvis
Associate Counsel

MAJ:msk

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Enc.